Introduction to Real Estate

Chapter 3: Methods of Financing

Standard: **Understand mortgages and methods of financing real estate investments** (CIP #08.1701-0301)

Objectives:

- Understand the various sources of funds for home mortgages.
- Identify the different types of government mortgage institutions.
- Discuss the secondary mortgage market.

Performance Objectives: **#2. Compare mortgage rates and fees of different brokers to determine who offers the best deal.**

Mortgages

Information: The evolution of mortgage lending has produced modern financial institutions that are capable of adapting to the changes in financial conditions and government activity. Familiarize yourself with the terminology below to better understand this section:

Real Estate Financial Terminology:

Mortgage - A long-term debt used to finance the purchase of a home.

Down Payment - The part of the selling price that a buyer pays at the time of purchase.

Closing Costs - Fees or charges made as part of real estate transaction.

Origination Fee - A fee charged by a lending institution for processing a loan.

Title - The legal claim of ownership.

Points - Extra fees lending institutions charge to use their money.

Equity - Value invested in the home.

Assessed Valuation - The value of the property as determined by the local government for tax purposes.

Market Value - The amount the property will bring when sold.

Earnest Money Deposit - money provided by the buyer to assure the agreement once the seller has signed the offer-to-purchase contract.

Escrow - Money held in trust by a third party (usually a real estate agent or lawyer) until the sale is finalized.

Conventional Mortgage - A 15-to-30-year loan whereby the borrower pays a fixed interest rate throughout the term of the loan. **Most popular type of loan.**

Adjustable Rate Mortgage - A loan where the interest rate changes after a certain length of time, usually from one to five years.

Graduated Payment Mortgages - A loan where the payments increase through the life of the loan at a rate determined when the mortgage is taken out.

Closing - The meeting of buyer, seller, real estate brokers, lender, and attorneys to finalize a real estate transaction.

The modern mortgage lender performs some of the following:

1. Originates mortgages on residential, commercial or income-producing properties for their portfolio or for sale to investors.

2. Arranges construction financing and/or makes construction loans.

3. Sells loans to secondary market investors.

4. Warehouses single-family home loans.

5. Services loans in their own portfolio or for their investors.

Various Sources of Funds for Home Mortgages

COMMERCIAL BANKS

The organization of a commercial bank is short term, as most assets are from checking accounts and other short term deposits which may be withdrawn with out notice. Other sources are from long term savings deposits, certificates of deposit, money market certificates, loans from other banks and equity invested by their owners. Their mortgage loan participation is limited and controlled. They can, however, act as a mortgage broker, making-up to 95% loans with private mortgage insurance. They like to make short term construction loans, home improvement loans, and mobile home loans. With the takeover of the savings and loans associations, the financially stronger commercial banks are gradually moving into the long term mortgage lending activities.

SAVINGS AND LOAN ASSOCIATIONS

At first called Building and Loan Associations, the savings and loan associations evolved specifically to provide loans to their depositors for housing construction. The savings and loan companies were federally supervised by the Federal Home Loan Bank Board from 1933 until 1989, when the supervision was transferred to the Federal Deposit Insurance Corporation. They have historically emphasized long term loans as well as short term construction loans. Their major source of funds is savings deposits made by individuals. They too can make a maximum residential loan up to 95% of value with private mortgage insurance. The Savings and Loan Associations have gone through an extremely difficult time. The recession of the early 80's and the slow real estate market proved a disaster for the savings and loan companies. Poor decisions in granting bad loans has lead to the closure of many S&L companies, and many sick companies were forced to merge with stronger companies, at a huge cost to the American taxpayer. In order to avoid the negative feeling of the failing savings and loan industry, most S&Ls have changed their names to “Savings Banks.”

LIFE INSURANCE COMPANIES

Insurance companies are less regulated than commercial banks. Each state regulates the activities of life insurance companies to different degrees. Life insurance companies have for years controlled a large percentage of all savings. They dominated the area of large commercial realty loans. They are (for the most part) letting others finance single family homes. One-third of their assets are invested in all types of realty loans. We have seen a renewed interest in residential real estate by the insurance industry. Metropolitan Life owns the Century 21 franchise for real estate sales and lending.

CREDIT UNIONS

Credit Unions are experiencing a new influx of savings deposits with payroll deductions from employee's earnings. The attraction is their ability to pay a higher rate of interest than savings and loans and commercial banks have been able to pay. They are rapidly getting involved in making first and second mortgages, some of which are sold in the secondary market.

MORTGAGE BROKER

Although a mortgage broker is not actually a lender, they are playing an ever-increasing part in the lending industry of today. The mortgage broker dos not actually make a loan. They only act as an intermediary in locating a source of funds for a party interested in obtaining a loan. **Mortgage brokers are not tied to a single funding institution, but may "shop" your mortgage around for the best rate.** In the residential lending industry they actually process the loan and submit a completed loan package to the funding lender. The funding lender pays a portion of the fees collected to the mortgage broker. Mortgage brokers also act as brokers on large commercial , industrial or income-producing loans.

SELLERS

Frequently, the sellers of a property are willing to carry a contract. This method has some distinct advantages, and some disadvantages. The seller retains title to the property until it is paid off. Should a buyer default on their payments, they may forfeit their mortgage, and full ownership will revert to the seller. Some of the reasons a seller may consider carrying the mortgage include the following:

(1) To avoid paying excessive taxes by taking the full sum in one bulk payment;
(2) High mortgage interest that may prevent an individual from qualifying for a new loan;
(3) Poor credit of the buyer—CAUTION!
(4) A property that will not qualify for a loan due to conditions that cannot be easily remedied.

Secondary Mortgage Market

The purpose of the **secondary mortgage market** is to purchase existing loans from the primary market (listed above), thus providing primary lenders capital to continue their business. The major secondary market sources are:

FNMA (Fannie Mae)—Federal National Mortgage Association.

FNMA is a privately owned, government regulated organization that purchases FHA, VA, and conventional mortgages with money raised through sale of corporate stock, notes, etc. to the public. It will sometimes purchase the existing mortgages at a discount.

GNMA (Ginnie Mae)—Government National Mortgage Association.
GNMA is a Federal agency that makes loans available in areas of higher risk, such as urban development and subsidy programs and for low and moderate income housing.

FHLMC (Freddie Mac)—Federal Home Loan Mortgage Corporation.
FHLMC is a Federal agency which originally purchased conventional mortgages from savings & loans, but now includes FHA and VA loans as well.

The Different Types of Government Mortgage Institutions

There are a variety of **government loans** that are made available to help the American people obtain homes earlier in their lives by providing relatively low interest rates and very low down payments. To obtain these FHA (Federal Housing Administration) and VA (Veteran's Administration) loans, the homes must be owner occupied. Although the programs apply to one-to-four family homes, recently, the government has been discouraging loans on anything but single family dwellings. It is not their purpose to assist the investor, but the home owner.

Federal Housing Authority (FHA)

In 1934, the federal government created the Federal Housing Authority (FHA). When the FHA was created, it's primary objectives were:

(1) To encourage the improvement of the nation's housing standards and conditions;
(2) To provide an adequate home financing system;
(3) To exert a stabilizing influence on the mortgage and residential real estate markets.

This program furthered the concept of amortizing loans and provided a system whereby funds could flow from a capital-rich area to a capital-poor area. The reason FHA was able to provide this conduit system for funds was that it established certain minimum standards for both the house and the borrower.

- When it first appeared, FHA was not immediately popular with the financial communities. Many feared the practice of guaranteeing mortgages by the government, since many of them had been severely burned by the mortgage guarantee companies of the 1930's. Others felt that this intrusion into the housing market by the government would, in the long run, be detrimental to private capitalization.

- The FHA-insured mortgage provided the elements of dependability, transferability, and minimal risk that were vital to the development of a national mortgage market. The mortgage lending industry as it exists today, undoubtedly owes it's unparalleled growth to this basic decision by life insurance companies to engage in national lending, with FHA providing the insurance.

FHA loans are insured, not guaranteed. This means the borrower must pay for insurance to protect the lender in the event foreclosure must take place. The Mortgage Insurance Premium (MIP) of approximately three percent is paid in cash at closing or it may be added into the loan amount. Technically, there is no such thing as an FHA loan, but rather it is an FHA approved loan.

Veteran's Administration (VA)

A minimal amount of single-family construction occurred prior to 1946 due to the Depression and World War II. **At the end of the war, five million men came marching home, creating a tremendous demand for housing**. The government, as part of it's responsibility to returning veterans, passed the Serviceman's Adjustment Act. One of the programs of the Act was the Veteran's Administration (VA) which provided means of financing homes for veterans.

- With the built-in demand for housing and with the FHA and VA available as vehicles, the way was made ready for the greatest boom in housing construction in the history of this country. From 1946 until the 1960's, mortgage banking companies grew from small, family owned companies to multibillion dollar corporations.

VA loans are guaranteed, not insured, meaning it is guaranteed by tax monies. A lender may loan 100% of the property value to a United States military veteran. This includes those who served in the Reserves or National Guard for 90 days of active duty during Desert Storm, as well as those who have been in the National Guard or Reserves for six years.

PRACTICAL APPLICATIONS

1. Contact a local mortgage company, bank, or credit union mortgage department and discuss the different types of loans they have available. Report your findings.

2. The United States economy relies heavily on the housing industry as an indicator of its well-being. What types of loans are designed to assist each of the following in the purchase of a home? Explain:

   A) Newlyweds

   B) Those who have served in the military

REQUIRED PERFORMANCE COMPETENCY

#2. Compare mortgage rates and fees of at least three different lenders to determine who offers the best deal. *(It's recommended to ask for a Good Faith Estimate from each lender, using the same loan amount)*

Introduction to Real Estate

Chapter 3: Methods of Financing

Standard: **The scope of home ownership**
(CIP #08.1701-0302)

Objectives:

- Understand the scope and responsibilities of home ownership.
- Determine the necessary steps in shopping for a home.
- Understand all aspects in financing a home.
- Understand the importance and usage of credit and credit reports.
- Identify parts of a Loan Application (Form 1003); Personal and Property Information, Employment, Income, Assets & Liabilities.
- Determine income qualification requirements.

Performance Objectives: **#3. Calculate qualification for a loan.**

Home Ownership

Information: If home ownership is your dream, it can become a reality, but not without realistic goals, sound advice, careful planning, and a clear understanding of the costs involved. The more you know about home-ownership, the better able you will be able to reach your goal. The decision to buy a home is certainly not one to be made lightly, because owning a home requires a significant investment in time, energy, and money. Therefore, the best way to start the home-buying process is by taking a realistic look at what you can expect from home ownership and what owning your own home implies. There are many good reasons for buying a home, provided you are ready for the increased responsibilities that come with home ownership.

<u>Scope and Responsibilities of Home Ownership</u>

The reason for buying a home can range from the purely personal to the very practical. The following are some of the **advantages** that might be considered.

A place of your own. "Your home is your castle."

Financial incentives. Owning your own home is a first-rate investment for a number of reasons.

Stable housing costs. While rents typically increase, the principle and interest portion of most mortgage payments remains unchanged throughout the entire life of the loan.

Increased value. Houses typically increase in value, or "appreciate" over time.

Tax benefits. Interest paid on a home mortgage is usually tax deductible.

- Despite its many attractions, home ownership is not for everybody. For one thing, buying a home is complex, time-consuming, and costly process that brings with it sometimes unwelcome responsibilities or **disadvantages**:

  High cost of ownership. Buying a home can put a considerable strain on a family's finances. Besides principal and interest, you must also pay property taxes, homeowners insurance, utilities, and up-keep expenses.

  Possibility of foreclosure. Foreclosure is the sale of a mortgage property by the lender when the borrower defaults on the mortgage. This can result not only in the loss of the house, but also the loss of the homeowners investment and good credit rating.

  Decreased mobility. A home buyer cannot move after simply giving the require notice to the landlord.

Repairs and maintenance. The next question a prospective homeowner must determine is whether or not they can afford to buy a house. Some expenses are "fixed" expenses (such as a car payment, taxes, day care, etc.) Others are "discretionary," offering flexibility in deciding how much, or how little, to spend in areas such as clothing and entertainment. An individual must decide how much they are willing to give up of put off in these areas in order to become a homeowner.

Necessary Steps in Shopping for a Home

The following are some of the main costs involved in purchasing a home:

Upfront costs. These include the down payment, various closing (or "settlement") costs, and the costs of moving and settling into a new home.

Down payment. Virtually all home buyers rely on a loan (or "mortgage") from a financial institution. Lenders will insist that you contribute a sizable chunk of your own funds (the down payment) as part of the deal. As with all loans, the larger the down payment, the smaller the rest of the payments will be. Often the seller of the home or the institution providing the mortgage demands a certain amount in down payment, ranging anywhere from 3% to 25% of the selling price depending on the type of loan.

Closing costs. Also known as settlement costs, this is the costs involved in completing the sale. Besides the down payment, there are a number of additional upfront costs involved in buying a home. These may include fees for lawyers, a property survey, real estate taxes, an engineering inspection, and recording the ownership transfer. Closing costs must be paid at or before closing, so you need to make sure that you have enough funds available to pay them. These expenses typically amount to an additional 3% to 6% of the amount of the mortgage.

Settling-in-costs. If a new home buyer spends all of their cash reserves on the down payment and closing costs, they may find themselves unable to meet additional expenses such as a necessary repairs, the purchase of a new refrigerator, etc.

Taxes and Insurance. Sometimes a mortgage payment also includes your home, mortgage, and /or flood insurance, plus property taxes. Money to be used for these items will be placed in an "escrow account" (also known as a "reserve" or "impound" account) so your lender can pay these items for you. If you chose NOT to include property tax as part of your monthly mortgage payment, then YOU are responsible for paying the full amount in a lump sum at the end of the fiscal year (Utah is NOT to pay homeowner's and/or other required insurances with your mortgage payment, it is again YOUR responsibility to keep these insurance payments current. Failure to do so, may result in the lender foreclosing on your house. Most lending contracts stipulate that the homeowner MUST have the property insured for the contract to be valid. Failure to do so renders the contract voidable, and may result in the lender taking possession of the property.

Ongoing Costs. As a homeowner, housing costs will include the monthly mortgage payment, property taxes, homeowner's insurance, utilities, water, maintenance, and in some cases Homeowner's Association Fees. You also have to consider the cost of keeping up a home. After a certain number of years, you may need to repaint, put on a new roof, or install a new furnace. Will you be able to afford these expenses along with everything else?

Income Qualification Requirements

Rule of Thumb for "Buying a House You Can Afford"

There is an often-quoted rule of thumb that says you can afford a house that costs up to **two and one-half times your annual gross income** (that is, the amount you make before taxes are deducted). This means a family having and income of $40,000 a year should expect to buy a home priced no more than $100,000. This provides a quick ballpark figure of the approximate amount you may be able to pay for a home, but your buying power ultimately depends on two things:

- how much you have available for the down payment, and
- how much a financial institution will agree to lend you.

Apart from the down payment, the other major factor limiting how expensive a home you can buy will be how much you can borrow. When applying for a mortgage loan, the lender will primarily consider two factors in determining how large a loan to grant.

- your earnings, and
- your existing debts

Lenders use two qualifying guidelines to determine what size mortgage an applicant is eligible for. They are as follows:

- Monthly housing costs (including mortgage payments, property taxes, insurance, and condominium or cooperative fee, if applicable) should total **no more than 28-30%** (top ratio) of the applicant's monthly gross income. *(The percentage adjusts depending on applicant's credit)*

- Monthly housing costs plus other long-term debts should total **no more than 36-42%** (bottom ratio) of your monthly gross income. *(The percentage adjusts depending on applicant's credit)*

- If, after going through the pre-qualification process, you are dissatisfied with the mortgage amount you will qualify for, an you may choose to lower their sights, or consider these three ways to increase your buying power:

1. Reduce your existing long-term debt
2. Wait to apply for a mortgage until your income increases, or
3. Find a financing option that results in a lower down payment and lower monthly mortgage payments.

Determine the Necessary Steps in Shopping for a Home

After you have considered how much money you can put toward a down payment and how large a mortgage you can qualify for, you will have a good idea of your price range, and you can begin shopping for a home. The following is a short guided tour of housing options to get you started.

New vs. older home. Eight out of ten home buyers purchase existing rather than new homes. Some people like the idea of moving into a brand new house, but many home buyers can't afford this luxury. On the other hand, many people prefer older homes because they often offer more special features and more space for the money. An individual who is handy with tools may be willing to consider a house that needs work (a handyman's special). Another person may insist on a home that is in extremes, and even finicky buyers often decide to accept some imperfections when they see the price of perfection. New homes are likely to have more efficient hearing systems, may be better insulted, and should cost less to maintain that older homes. Older homes, on the other hand, may be larger, more individual, or made with better quality materials.

Location. For many people, the location of the home they buy is their most important consideration. The home buyer should consider what is important to them—do they need to find a house that is near their job site, public services, or daycare facilities, or are they able to travel some distance to a form work in order to live in a house with a yard? Are neighborhood schools a major factor in their home-buying decision? Is nearness to shopping, recreational activities, or public transportation particularly important? Two identical homes may be priced very differently depending on their location. Neighborhoods have definite personalities.

Size requirements. In determining what size house to buy, it is important to consider both current and future housing needs. It is wise to choose a house that will be adequate for at least the next five to fifteen years.

Financing A Home Loan

Once the perfect—or nearly perfect home—is found, it is time to shop for the best mortgage. As discussed in the previous section, there are a variety of loan types available, and terms can very from one lender to another. The following are some of the items needed to determine who has the best "deal" for you.

Principal. Amount borrowed from lender.

Interest rate. Lenders change their rates often, even daily. In addition, the same lender will quote different rates for each specific type of loan it offers. The interest rate not only determines how large a mortgage you can qualify for, but the size of the monthly payments. **Following is an easy way to quickly "estimate" what you monthly mortgage payment will be (principal and interest only). For our purposes only, we'll refer to it as: The Rule of Ten's.** Rule of thumb to approximate monthly mortgage payment (includes principal & interest).

The Rule of Ten's. Rule of thumb to approximate monthly mortgage payment (includes principal & interest).

For every $10,000 borrowed, multiply that number by the interest rate times 10.

Example: $180,000 borrowed at 7.5% interest

$180,000 ÷ $10,000 = 18
7.5 x 10 = 75
18 x 75 = $1,350 (P&I payment)

Points. Lenders typically charge a loan origination fee in the form of points. Each point is equal to 1 percent of the loan amount. Each point paid is roughly equal to 1/8 of a percent point added to the interest rate. For example, a 10% loan and 2 points are roughly equivalent to a 10-1/4 % loan. Points are usually paid as a one-time expense at closing.

Annual Percentage Rate (APR). Don't be overly concerned when you receive an APR statement upon closure of your loan that you were misquoted your interest rate by your lender. This is the actual **interest rate that includes the discount points and other costs of financing (in addition to the interest rate you've locked- in at).** The APR allows you to easily compare various combinations of interest rates and number of points that lenders quote, and is required to be disclosed by the lender.

Loan term. Most home loans are repaid over 15 to 30 years. With a shorter repayment loan term, you pay for less interest over the term of the loan, but your monthly payments will be higher. Alternative loan programs offer bi-monthly payments (i.e., $1000 monthly payment, you pay $500 every two weeks). This requires two months to pay 3 payments *(equal to one extra payment per year).* This shortens a 30-year loan to approximately 22 years.

Down payment requirements. Ask what a lender's lowest allowable down payment is.

Private Mortgage Insurance (PMI). If mortgage insurance will be required, how much will it cost? Ask about the up front cost (payable at closing) and the monthly premiums. Lenders are required to cancel PMI when the **LTV (Loan-to-Value)** ratio drops below 80% of the purchase price (or appraised value, if a refinance loan).
Example: Appraised Value of Home = $100,000; Loan "Balance" = $80,000

Rate lock-in. When a lender quotes an interest rate, that is the rate in effect today, but it may not be the rate available to you when you actually close the loan. Since a higher interest rate may reduce the size of the mortgage for which you qualify, it is important for you to know whether a lender will agree to hold the quoted rate for you. This is called "lock-in."

Some of the questions you should ask when locking-in a rate are:

1. If the lender will lock-in a rate, when will it do so—at the time of application or only upon approval?
2. Will the lender lock in both the interest rate and the points?
3. Can you get a written lock-in agreement?
4. How long does the lock-in remain in effect?
5. Is there a charge for locking-in a rate?
6. If the rate drops before closing, can you lock-in at a lower rate?

Processing time. How long does this lender normally take to process a loan application? Traditionally, loan approvals take 30 to 60 days or more. Some lenders now promise very short approval times (some within 24 hrs), which may be an advantage, especially in times of rising interest rates.

In processing your loan application, the lender primarily will be interested in two things:

1. The property that you plan to buy (since it serves as collateral for the loan)
2. Your financial situation and your credit history.

Other Items Needed to Process and Close a Loan

The lender will request:

- An appraisal of the property
- A credit report on you and any co-borrowers, and
- The lender also will verify the information provided on the loan application as to your income and employment history, your assets (checking and savings accounts, etc.), debts (credit cards and loans), and your rent payment history.

Once a loan is approved, the lender will send you a commitment letter. This is the formal loan offer. It will state the loan amount, the term of the loan, the loan origination fee, the points, the annual percentage rate, or APR. By signing the commitment letter, you accept the terms and conditions of the loan offer.

Transferring of a Loan

While you may start the loan process with a lender or mortgage broker, you could find after settlement another company may be collecting the payments on your loan. This is called transferring a loan. Your lender may sell your loan on the secondary mortgage market, and another company takes over collecting the payments. This is nothing to worry about, and is quite common. If your monthly mortgage payments are deducted automatically from your bank account, you won't even notice the transfer other than a letter of confirmation from the new lender. If you are sending your mortgage payments by check each month, the lender will give you the new mailing information.

Assumable Loans

A buyer can "assume" or "take over the payments" of the seller's original loan. This is beneficial if the seller's original loan has a low interest rate, and he's trying to sell in a slow real estate market that has higher rates. The buyer is required to qualify for the loan amount, and if he defaults (quits making payments), the original seller is still liable for the loan amount and his credit is negatively affected. Because of this fact, assumable loans are less popular than they once were. *Some loans will not allow for assumptions, as stated in its conditions.*

Importance and Usage of Credit and Credit Reports

As mentioned previously, an important step in processing a loan is obtaining a credit report on the borrower and co-borrower. The credit report—a type of consumer report—contains information about where you work and live and how you pay your bills. It also may show whether you've been sued or arrested or have filed for bankruptcy. Companies called consumer reporting agencies (CRAs) or credit bureaus compile and sell your credit report to businesses. Because businesses use this information to evaluate your applications for credit, insurance, employment, and other purposes allowed by the Fair Credit Reporting Act (FCRA), it's important that the information in your report is complete and accurate.

FICO Scores

FICO *(Fair Isaac Credit Organization)* scores are provided to lenders by the three major credit reporting agencies: Equifax, Experian and TransUnion. The FICO score is calculated by a mathematical equation that evaluates many types of information on your credit report. By comparing this information to the patterns in hundreds of thousands of past credit reports, the score identifies your level of future credit risk.

Your FICO scores are a measure of your financial responsibility, based on your credit history. Most lenders will look at your FICO scores when evaluating your credit or loan applications.

- In order for a FICO score to be calculated on your credit report, the report must contain at least one account which has been open for six months or greater. In addition, the report must contain at least one account that has been updated in the past six months. This ensures that there is enough information—and enough recent information—in your report on which to base a score.

FICO scores provide the best guide to future risk based solely on credit report data. The higher the score, the lower the risk. But no score says whether a specific individual will be a "good" or "bad" customer. And while many lenders use FICO scores to help them make lending decisions, each lender has its own strategy, including the level of risk it finds acceptable for a given credit product. There is no single "cutoff score" used by all lenders and there are many additional factors that lenders use to determine your actual interest rates.

How FICO scores may affect your Interest Rate (30-year Fixed loan)

Loan Amount $250,000	FICO Score	Interest Rate	Monthly Payment (P & I)	Total Interest Only	Total Paid 30 years
	720-850	5.78%	$1,463.70	$276,932	$526,932
	700-719	5.905%	$1,483.64	$284,110	$534,110
	675-699	6.443%	$1,570.81	$315,492	$565,492
	620-674	7.593%	$1,763.98	$385,033	$635,033
	560-619	8.531%	$1,927.78	$444,001	$694,001
	500-559	9.289%	$2,063.76	$493,018	$743,018

On a $250,000 loan, the difference in interest paid for a "Excellent" FICO score and a "Bad" score is staggering.

Check Your Credit Often

Some financial advisors suggest that you periodically review your credit report for inaccuracies or omissions. This could be especially important if you're considering making a major purchase, such as buying a home. Checking in advance on the accuracy of information in your credit file could speed the credit-granting process.

Accurate negative information can generally stay on your report for 7 years. There are certain exceptions:

- Information about criminal convictions may be reported without any time limitation.
- Bankruptcy information may be reported for 10 years.
- Credit information reported in response to an application for a job with a salary of more than $75,000 has no time limit.
- Credit information reported because of an application for more than $150,000 worth of credit or life insurance has no time limit.
- Information about a lawsuit or an unpaid judgment against you can be reported for seven years or until the statute of limitations runs out, whichever is longer. Criminal convictions can be reported without any time limit.

The Loan Application

In order to begin the loan process, one must complete a Loan Application—also known as Form 1003 *(pronounced ten-oh-three)*. All information must be accurate and verified by the prospective lender. All information must be completed for both a borrower and co-borrower, if applicable. Parts of a loan application include; Type of mortgage, property information and purpose of loan, borrower information, employment information, monthly income, assets and liabilities, and other declarations.

A loan officer will ask prospective buyers a series of questions about their finances. This is only a pre-qualification, and is not a commitment to loan: that step is much more detailed and involved. The following is an example of a loan qualifying format:

REQUIRED PERFORMANCE COMPETENCY:
#3. Calculate a Loan Qualification

Name:__________________________ **Loan Amount:** **$**_______________________

______Borrower's Monthly Gross Income $__________________

______Co-borrower's Monthly Gross Income + $__________________

______Other Gross Monthly Income *(if not already added* + $__________________
_______________________________*into above amounts)*

_________TOTAL INCOME (A) $__________________ (A)

Proposed Mortgage at _______% interest

Estimated Principal & Interest *(Use "Rule of 10's")* $__________________

Property Taxes *(Market Value x .00878) ÷ 12 months* + $__________________
—or— *(Sales Price x .00878) ÷ 12 months*

Hazard Insurance *(25% of taxes)* + $__________________

Home Owner Association Dues *(If applicable)* + $__________________

Private Mortgage Insurance *(If applicable)*
(Loan Amt x .0034) ÷ 12 months + $__________________

TOTAL MORTGAGE PAYMENTS (B) $__________________ (B)

Monthly Debts (Liabilities) + $__________________

*TOTAL MONTHLY OBLIGATIONS (C) $__________________ (C)

(B÷A) Monthly Payment ÷ Gross Monthly Income __________________% (28%)

(C÷A) Total Monthly Obligations ÷ Gross Monthly Income _________________% (36%)

Acceptable Ratios:
Conventional—25% to 28% and 33% to 36%
FHA—29% to 31% and 41%
VA—One ratio only of 41%

*** Total monthly obligations includes:**
Car payment, credit cards, loans, and other debts

Does this Borrower Qualify for a Conventional Loan? Yes No

Chapter 3: Methods of Financing

Standard: **The title search and closing process**
(CIP #08.1701-0303)

Objectives:

- Discuss the need for the title search.
- Review the types of ownership.
- Discuss the obligations of a borrower.

Title Search & Closing

Information: The mortgage loan closing (or “settlement,” as it is called in some parts of the country) is the meeting in which your loan is finalized, your mortgage is issued, and you get the keys to your new home. In this section we will look at what needs to happen in the final weeks before closing—such as title search, a survey of the property, and the buyer’s final walk-through inspection. We will then look at what to expect on closing day, including the signing of documents and the payment of closing costs.

- The final days and weeks prior to closing can be a stressful period for both buyer and seller. The buyer may have second thoughts at the prospect of taking on such a large debt, or they may worry that something will happen to prevent the sale.

- The **closing date** is set after your loan has been approved and the commitment letter is accepted. Often , the real estate agents will coordinate this. It is important to make sure that the closing takes place before the lender's commitment expires and while the rate lock-in, if there is one, remains valid. You can now make definite moving plans.

- In Utah, the **settlement agent** is usually a title company. This may vary widely throughout the country. Other settlement agents may include the lending institution, escrow companies, real estate brokers, or attorneys for the buyer or seller.

- If the home being bought is found to be in violation of a building code or zoning regulation, the lender's commitment letter may specify that those problems must be corrected before the closing. If that is the case, it is important that these conditions be met, or closing will not take place.

The Need for a Title Search

Before the closing a title search of the property should be made and title insurance has been issued. Lenders require a **title search** to prevent fraudulent sales. They want to be sure that the seller is indeed the owner of the property. The title search also attempts to uncover any “encumbrances” on the title. This includes **liens** (legal claims against a property) filed by creditors in an attempt to collect unpaid bills, as well as liens filed by the IRS for non-payment of taxes. Any such claims against the property must be paid before (or often at) closing. The buyer typically pays for the title search.

As further insurance that the seller is giving the buyer a “marketable title,” the lender will require that title insurance be bought.

There are two types of policies, and you should get both:

1) a lender’'s policy, and
2) an owner’s policy

The **lender’s policy** protects the lender in the event a flaw in the title is detected after the property has been bought.

The **owner's policy** protects the buyer. Generally **the buyer pays the cost of both**, and obtaining a combined lender's/owner's policy will save you some money. You may also get a price break if the company that previously insured the title will give you a "reissue" policy.

- The lender may require a **survey** of the property before closing. This is done to confirm that the property's boundaries are as described in the purchase and sale agreement. This is another charge that is normally **paid by the buyer**. This survey, or plot plan, may show that a neighbor's fence extends onto the seller's property (or visa versa). Sometimes more serious violations are uncovered that must be addressed.

- In many locations, homes are required to be **inspected for termites** before they can be sold. Usually the **seller pays** for this. You want a certificate from a termite inspection firm that states that the property is free of both visible termite infestation and termite damage.

- The lender will require that you purchase **homeowner's or "hazard" insurance**, which protects you and the lender from loss in the event the house is damaged or destroyed by fire or storm. Most home buyers purchase a homeowner's package of insurance that includes:

    - **Personal liability insurance**, which protects you in the event you are sued by someone who is injured on your property or injured by a member of your family, except in an automobile accident; and

    - Coverage against **fire, theft, and certain weather-related hazards**.

  Lenders typically want the first year's insurance premium to be paid at or before closing. A lender may insist on paying subsequent hazard insurance premiums in order to ensure that the policy remains in effect for the life of the loan. If so, the cost of the insurance policy will be added to your monthly mortgage payments. The lender will keep this portion of the payment in an escrow account and will pay the insurance bill when it comes due each year.

- If you're buying a new home, you may be able to get a **homeowner's warranty**, that protects against certain defects in your home. Both the homeowner's warranty and a **certificate of occupancy** should be provided at closing. Without this certificate, it is illegal to live in a newly constructed home. Recently, homeowner's warranties have become available for older homes as well, typically covering repairs of the major systems during the first year of ownership.

- Your contract should have included a clause allowing you to examine the property within 24 hours prior to closing. This allows you to make sure that the seller has vacated the house and left behind whatever property (such as appliances) that was agreed upon. You also can make sure that all conditions in the contract have been satisfied. Typically, the real estate agent should accompany the buyer during the inspection. During the **walk-through**, all deficiencies should be noted. If they cannot be corrected before settlement, funds may be withheld from the seller for payment of the agreed-upon repairs. If major problems or violations of the purchase contract are observed, the buyer has the right to hold up settlement until they are corrected.

- The lender is required to give the buyer an estimate of closing costs soon after the buyer has filed their application for a loan. Since these estimates are subject to change, you have the right to inspect the settlement form one business day before settlement.

- In most places, the **closing** is a formal meeting with the title company representative, typically attended by the buyer and the selling agent, and separately by the seller and the listing agent. (All four may attend together, but it is not recommended.) An attorney for either party may attend to assist in the reading of documents, and advise you concerning the signing of papers, and generally to represent your interests at this final important meeting. You will be asked to sign numerous documents and affidavits, you will pay the closing costs assigned to you, and you will be given the keys to your new house!

Types of Ownership (Review)

The name or names on the deed must normally be the same as those who will be responsible for the mortgage. The type of ownership is a item that you might want to discuss with an attorney. A brief review of the chief options include:

1. **Sole ownership**. You are the only owner.

2. **Tenants by the entirety.** Available only to married couples, both owners have to agree before the house can be sold or even refinanced; when one spouse dies, the house automatically goes to the surviving spouse without going through **probate**, the legal process by which property is distributed after someone's death.

3. **Joint tenancy**. During their lifetimes, any of the owners may sell their interest to whomever they choose; when one owner dies, the surviving owner automatically gets the deceased owner's share in the property.

4. **Tenancy in common**. The property is owned jointly, but if one owner dies, the deceased owner's share goes to his or her heirs rather than to the surviving owner.

PRACTICAL APPLICATIONS

1 Using the back side of a SETTLEMENT STATEMENT, determine which items will

be paid for by the buyer, and those to be paid by the seller.

2. Invite a guest speaker from one of the local title companies to visit your class and discuss the steps involved in the title search and closing process. Or, visit a title company and gather information from them that can be shared with the rest of the class.

Supplemental Forms and Documents

1. Good Faith Estimate
2. Federal Truth-in-Lending Disclosure Statement (APR)
3. Uniform Residential Loan Application (Form 1003)
4. Settlement Statement (Closing Statement)
5. Credit Report
6. Sample Credit Report
7. Commonly Asked Questions About Credit Files
8. Mortgage Amortizations:
    - $157,000 loan (10½% interest rate @ 30 years)
    - $157,000 loan (8% interest rate @ 30 years)
    - $157,000 loan (8% interest rate @ 15 years)
    - What happens when you pay additional $200/month towards principal
    - Car loan sample ($15,000 loan; 10% interest rate @ 5 years)